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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1980

No. .....

JOHN and NORMA OGIONY, *et al.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Questions Presented

I. Whether, where a corporation used solely to insulate a bank from the defense of usury, held title of record incident to the mortgage financing, the Court of Appeals should have ignored the Supreme Court's holding in *F. & R. Lazarus & Co.*, 308 U.S. 252, (that the record owner of the property is not necessarily the true owner for tax purposes) and, instead, applied the rule in *Moline Properties, Inc.*, 319 U.S. 436, (that a corporation serving a business purpose, however minimal, cannot be ignored for tax purposes)?

II. Whether, when the IRS has "allocated" and "attributed" the net losses of a joint venture to a corporation owned or controlled by the joint venturers pursuant to Section 482 of the Code and issued Section 482 correlative adjustment letters, the Petitioners can be denied a judicial determination of the Section 482 issues simply because the Commissioner deceptively camouflaged the allocation as a "disallowance" and "allowance", and his counsel denied that a Section 482 adjustment had been made, thus creating a conflict with the Third Circuit Court of Appeals' holding in *Chelsea Products*, 197 F2d 620 (1952), that a deceptive deficiency notice did not bar that Court from treating it as a Section 482 allocation.?

III. When the Commissioner says he relied on Section 61 of the Code in allocating (disallowing and allowing) all of the net losses from one business entity to another business entity owned or controlled by the same persons, should the Petitioner be denied a judicial inquiry into who incurred the liabilities, assumed the risks, paid the bills, performed the services, sustained the losses and who were the true owners of the property, this denial being in conflict with the holding of the Fifth Circuit Court of Appeals in *Grenada Industries, Inc.*, 202 F2d 873 (1953), that in the case of attributions of income among organizations under common control, the Court must treat it as a Section 482 case, Congress having enacted it for that very reason?

IV. Have not the Petitioners been unfairly deprived of their judicial remedies when both the United States Tax Court and the Second Circuit Court of Appeals sidestepped, without discussion, the contentions the Petitioners actually made and pretended, instead, that they

had contended exactly the opposite and decided the case on these spurious issues? Was it proper for these courts to substitute contentions and issues which the Petitioners had expressly disavowed?

V. Why should both the United States Tax Court and the Second Circuit Court of Appeals have catered to the hypocrisy practiced by the Commissioner by affirming his litigating position that only the corporations used to insulate the bank from the defense of usury can claim the operating losses, knowing that the Commissioner had issued private letter rulings and contemporaneous formal published rulings saying he would recognize the joint ventures as the true owners for tax purposes?

Parties to the Proceeding

Petitioners, John and Norma Ogiony, John J. and Gloria Nasca, Joseph M. and Nancy Nasca, Edward L. and Ruth M. Ogiony and Peter Santin and Enis Santin pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit in these cases.

Opinions Below

The opinion of the United States Court of Appeals (Appendix A, *infra* pp. 17-25) is reported at 38 TCM 125. The opinion of the Court of Appeals (Appendix B, *infra* pp. 26-61) is reported at 80-1 USTC §9265.

Jurisdiction

The judgment of the Court of Appeals was entered on February 22, 1980. A Petition for Rehearing was denied and filed by the Court of Appeals on May 7, 1980 (Appendix C, *infra* pp. 62-63). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Statutes and Regulations Involved

The relevant provisions of the Internal Revenue Code of 1954 and the Treasury Regulations on Income Tax (1954 Code) are set forth in (Appendix D, *infra* pp. 64-67).

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Statement of the Case

The Facts

A joint venture, as a developer of an apartment complex was obliged to provide a corporate signature to insulate the bank from the defense of usury in order to obtain mortgage financing.

The corporation was never more than a minute book and a corporate seal in the lawyer's office. It did nothing but passively hold bare legal title to meet the bank's requirement that record title be in a corporate name when all mortgage papers were signed and advances made on the building loan.

In every other respect, the joint venturers constructed the complex just as they would have done if the bank had made the loan direct to them. They personally incurred all liabilities to subcontractors, suppliers, tradesmen, utilities, etc., paid all of the bills and performed all the functions of a developer in their own names.

Building loan financing requires the developers to pay for everything with their own funds to bring the project to the various stages of completion that qualify for building loan advances. All told, they invested $641,000 of their personal funds between 1967 and 1970. At the end of 1970, they had $164,000 left. The $477,000 had been expended for purposes qualifying as deductions under Sections 161 through 167 of the Code.

Argument

I

The Commissioner said only the corporation, as the *owner* of the property, could deduct them. Actually, it had nothing to deduct them from, never having conducted business and having reconveyed title to the joint venture on completion.

The Second Circuit affirmed the Tax Court's holding that only the corporation could deduct the operating expenses, citing, *inter alia*, *Moline Properties, Inc. v. Comm.*, 319 U.S. 436 (1943).

The use of straw corporations to avoid the usury statutes is a development of the late 1960's and the 1970's. It is a financing technique to insulate the bank from the defense of usury. Every borrower in a state with a usury ceiling below the market price of money has had to go this route.

Both the Tax Court and the Second Circuit refused to even discuss the decision of the Supreme Court in *Helvering v. F. & R. Lazarus Co.*, 308 U.S. 252 (1959).

There, to avoid the payment of the tax on mortgage bonds, the bank rearranged the mortgage transaction as a sale and leaseback. It was a financing technique.

The Commissioner taxed F. & R. Lazarus on the grounds that the "statutory right to depreciation follows legal title" (precisely the same reasoning used here).

If they had followed F. & R. Lazarus, they would have had to hold that the corporation was owner in name only and only for the purpose of providing the bank with security for an otherwise usurious loan.

There is also an irreconcilable conflict between the decision here and that of the Fourth Circuit Court of Appeals in *U.S. v. Brager Building Corp.*, 129 F2d 149 (1941), holding that a no-asset corporation passively holding title to a department store for a partnership was not the true owner for tax purposes. The partnership was. Similar holdings in other Circuits are too numerous for citation here.

II

The District Director[1] made a Section 482 "allocation" and "attribution" of the $477,000 from the joint venture to the corporation and issued Section 482 correlative adjustment letters. This presented a factual issue which the government was bound to lose.

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[1] This is just one illustration of how the Second Circuit sidestepped arguments it could not answer. The Commission does not make Section 482 allocations. District Directors are instructed by the Regulations to invoke Section 482 whenever appropriate. (See underlined portions of the Regulations in Appendix D). Once invoked by them, the taxpayers are stuck with the tax consequences of a Section 482 allocation. Yet, the Courts pretend no such allocation was made unless the Commission is honest enough to admit it.

Recognizing this, the Commissioner cleverly disguised the allocation as a "disallowance" and an "allowance" to invoke the Tax Court's policy of refusing to look behind statutory notices. It was only a matter of semantics, with the computation and deficiency remaining unchanged.

Counsel for the Commissioner maintained the charade by denying that any Section 482 issue was present, saying, instead, that the Commissioner relied on Section 61 for disallowing the losses to one and allowing it to the other.

Petitioners' contention was that both the joint venture and the corporation were business organizations which *could not* be ignored for tax purposes. Furthermore, they were owned or controlled by the same persons. Therefore, the only Code section under which the Commissioner could transfer the net income or loss from one to the other was Section 482. It was farcical for the Commissioner's counsel to hide behind a doctored 90-day letter.

Both the Tax Court and the Second Circuit rejected this contention on the policy grounds that the Courts "refuse to look behind the statutory notice."

The Second Circuit said that the Commissioner need not inform taxpayers "which provisions [he] relied on in making his determination." This is a dangerous precedent. It invites deception by authors of 90-day letters and puts taxpayers at the mercy of how I.R.S. attorneys choose to interpret them for the Courts.

This places the Second Circuit in direct conflict with the holding of the Third Circuit in *C.I.R. v. Chelsea Products, Inc.*, 197 F2d 630 (1952). There, the deficiency

notice said that certain dollar amounts "represents net income taxable to you." It did not mention Section 45 (now 482), nor even used the allocation or attribution language of that Section.

The Third Circuit described the deficiency notice as "deceptive" and said that the Commissioner had a duty to fairly apprise the taxpayer of the statutory grounds on which the deficiency had been assessed. There, the taxpayers got the full benefit of a Section 482 analysis.

III

Under the compulsion of answering interrogatories, the Commissioner said he relied on Section 61 of the Code. He used the same evasive tactic in *Grenada Industries, Inc. v. C.I.R.*, 17 T.C. 231, aff'd 202 F2d 873 (5th Cir. 1953). The Fifth Circuit affirmed this analysis by the Tax Court) as a thorough and correct exposition of the law:

> "In such circumstances, the general provisions of Section 22(a) [now Section 61] are undoubtedly sufficient to charge the income to the one that actually earned it. . . but in the case of organizations under common control, the detailed provisions of Section 45 [now Section 482] of the Code explicitly authorize the Commissioner to unscramble any such situation, so that income may be charged to the organization that earned it. Thus, to the extent that Section 45 may be applicable, Section 22(a) adds nothing to the strength of Respondent's position here. We pass, therefore, to a consideration of Section 45."

Both the Tax Court and the Second Circuit ignored *Grenada Industries, Inc.* and said they were *bound by the Commissioner's denial* that a Section 482 issue existed.

IV

Petitioners contended that the corporation *could not* be ignored for tax purposes. Consequently, the government could not ignore it as a taxable business entity within the meaning of Section 482. This was the very cornerstone of the Petitioners' argument in both Courts.

Both Courts disposed of that issue in one paragraph by "refusing to look behind the statutory notice."

Having nothing else to write about, they then pretended the Petitioners had been so stupid as to make the same argument that had been rejected in *John R. Collins, III*, 386 F. Supp. 17, aff'd *per curiam*, 514 F2d 1282 (5th Cir., 1975) and *William B. Strong, et al. v. C.I.R.*, 66 T.C. 727, aff'd without opinion, 39 A.F.T.R.2d 77-394 (2nd Cir., 1977).

Collins had stipulated that if it could not be ignored for tax purposes, his cause was lost. He lost because of *Moline Properties, Inc.*

All *Strong* argued was that the corporation was a mere agent or nominee of the partnership which should be ignored for tax purposes. He lost, too, because of *Moline Properties, Inc.* and *National Carbide Corporation.*

These were spurious issues invented by the Tax Court as "filler" and parroted by the Second Circuit. This type of treatment at the hands of the judiciary is unconscionable.

V

Judge Oakes, concurring in the opinion of the Second Circuit, was "troubled" by the Commissioner's private ruling to a Minneapolis corporation that the developer would be treated as the owner, builder and original user for federal income tax purposes, entitled to all of the deductions allowed by Sections 162-164 and 167 and that he viewed the corporation formed to avoid the usury statute as only a nominal owner, holding bare legal title to the land and improvements in a financing arrangement.

Judge Oakes did not disclose the real hypocrisy of the Commissioner, demonstrated by his issuance of Rev. Rul. 75-31, 1975-1 C.B. 10 and Rev. Rul. 76-26, 1967-1 C.B. 10, announcing that, on facts indistinguishable from these, two different New York corporations would be ignored for tax purposes and that he would treat the partnerships as the true owners of the land and improvements even though they had conveyed title to asset-less, inactive corporations.

Apparently, neither Judge Mulligan nor Judge Oakes (Judge Gurfein having died two days after their voting conference) were "troubled" by the startling pronouncement of the I.R.S. reported to them in a Petition for a Rehearing *En Banc*.

Emboldened by their decision, the I.R.S., on 1980, issued Ltr. Rul. 7950003 stating that even though a corporation formed to avoid the usury statutes held record title only for the "one minute" it took to obtain the loan and then immediately reconveyed record title to the partnership throughout the construction period, it was never-

theless the owner of the property for tax purposes and any operating losses claimed by the partnership would be disallowed.

One has to wonder if they would not have been just as "untroubled" by the fact that the same Tax Court (and the same Judge) held, on April 15, 1980, that even though a corporation formed to avoid the usury statutes could not be ignored for tax purposes, its stockholder was the true borrower and could deduct the interest paid on the corporate borrowing. See *Raymond J. Beran,* 40 TCM 163.

Reasons for Granting the Writ

These questions have far reaching implications because:

1. This is only one of thousand of instances in which developers of commercial property were forced by the bank's demands for protection from the usury statutes to use dummy or straw corporations to borrow money. It was the only way private venture capital could get access to mortgage financing for apartment projects, shopping plazas, office and professional buildings, warehouses, manufacturing plants and similar rental properties.

2. The arbitrary position of the I.R.S., sustained by Courts that seem to lack any comprehension of economic realities or the facts of business life, has driven all private developers and many of their subcontractors and materialmen in New York State out of business. Construction has been limited to such things as nursing

homes and highrise dwellings for the elderly financed by state or federal funds which bypass the usury statutes.

3. The success the IRS has had in the courts has proven to be a major disaster for the U.S. Treasury. What it has collected from a dozen or so developers to date is a mere pittance compared with the hundreds of millions of dollars of construction projects that stayed on the drawing boards after the IRS and the Courts terrified every builder, developer and lending institution by huge deficiencies against people who, in good faith, had chosen to conduct their business as sole proprietors, joint venturers or partners. Only the unaware or the foolhardy would do this at the peril of paying taxes on the operating losses in addition to sustaining the operating losses.

Telling these bankers and builders to seek legislative help would be asking the impossible. They have already pleaded with the State legislatures for realistic usury ceilings to no avail. If the Supreme Court won't listen, Congress won't either. So, the construction industry in every state where corporate signatures have to be supplied remains stagnated because the IRS is indifferent and the Courts are out of touch with things that any mortgage loan officer, real estate developer or real estate lawyer could tell them, *i.e.*, that they are taking only a superficial look at the form and ignoring both the facts and the substance.

4. The constant repetition of the quote from *Moline Properties, Inc.* as being the law of the case, *i.e.*, that "the doctrine of corporate entity fulfills a useful purpose in business life. . . .", though profound, has blinded the

Courts to the fact that the doctrine of joint venture and partnership entities also fulfills a useful purpose in business life. *Moline Properties* is not the proper precedent for the unprecedented financial crisis created by the conflict between the usury statutes and the market price of money.

5. The net result of these cases is offensive to any one with any common sense and contrary to the basic tenet of the Tax Law that income is chargeable to the one who earns it and business expenses are deductible by the one who incurs and pays them. Here, the taxpayers lost $477,000 of their own personal funds, yet the Courts have said that a corporation that did not have $477,000 to lose and did not lose anything, lost it.

This single fact shows that it was a revolting miscarriage of justice that cannot be obscured by any amount of learned debate over what constitutes a taxable entity, whether Courts should look behind statutory notices, whether incorporating to contravene public policy by avoiding the usury laws is a business purpose or any other extraneous law school examination type question.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: July 21, 1980

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APPENDIX A

Opinion of the United States Court of Appeals

UNITED STATES COURT OF APPEALS

For the Second Circuit

Nos. 504, 505, 506, 507, 508—September Term, 1979.

Argued December 10, 1979

Decided February 22, 1980

Docket Nos. 79-4147, 79-4149, 79-4151, 79-4153, 79-4155

JOHN and NORMA OGIONY, JOHN J. and GLORIA NASCA, JOSEPH M. and NANCY NASCA, EDWARD L. and RUTH M. OGIONY, PETER SANTIN and ENIS SANTIN,

Petitioners-Appellants,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before: Mulligan, Oakes and Gurfein,*

Circuit Judges.

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* Judge Gurfein voted to affirm the judgment of the Tax Court at a voting conference on Friday, December 14, 1979, prior to his death on December 16, 1979. He did not have the opportunity, however, to see this opinion prior to his death.

Appendix A—Opinion of the United States Court of Appeals.

Appeal from a decision of the Tax Court, Cynthia Hall, Judge, ruling that appellants were not entitled to deduct net operating losses incurred with respect to property owned by their corporations.

The decisions of the Tax Court are affirmed in all parts except that the case is remanded to the Tax Court so that it may amend its mathematical computation of deductions allowed to appellants in accordance with this opinion.

Ralph J. Gregg, Buffalo, New York (George M. Zimmermann, Philip John Szabla, Albrecht, Maguire, Heffern & Gregg, P.C., of counsel), for Petitioners-Appellants.

Robert T. Duffy, Washington, D.C. (M. Carr Ferguson, Assistant Attorney General, Gilbert E. Andrews, Jay W. Miller, Tax Division, Department of Justice, of counsel), for Respondent-Appellee.

MULLIGAN, *Circuit Judge:*

This is an appeal from a decision of the Tax Court, Cynthia Hall, Judge, 38 T.C.M. 125 (1979). The facts, most of which were stipulated by the parties, are set forth in detail in Judge Hall's opinion. For the purposes of this appeal, they may be summarized as follows.

Appellants[1] or their wholly-owned corporations formed two partnerships, P. Santin, J. & E. Ogiony, A.

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[1] Appellants Norma Ogiony, Gloria Nasca, Nancy Nasca, Ruth M. Ogiony and Enis Santin are parties to this litigation solely because they filed joint returns with their husbands during the years at issue. Thus, we shall use the term "appellants" in setting forth the facts of this case to refer to John and Edward Ogiony, John and Joseph Nasca, and Peter Santin.

Stangl—Joint Venture in 1966 ("Garden Partnership") and Losson Gardens Company in 1969, for the purpose of building rental apartments on certain pieces of underdeveloped real estate in Cheektowaga, New York. They were unable to obtain financing for the projects because the market interest rate at that time for non-residential mortgage financing exceeded the maximum chargeable to individual borrowers under the usury laws of New York,[2] Corporations, however, may not interpose a defense of usury in New York. N.Y. Gen. Obligations Law §5-521 (McKinney 1978). Therefore, appellants utilized two corporations, Garden Village Builders, Inc. ("Garden Corporation") and Losson Gardens, Inc. ("Losson Corporation"),[3] as corporate signatories in order to obtain the commercial loans necessary to develop the apartment projects.

The partnerships transferred title to the parcels of land they intended to develop to the corporations, which then became the mortgagors of record. For most of the time throughout the financing period, the corporations retained title to those parcels. However, the corporations'

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[2] General Obligations Law Section 5-501 applicable at that time limited the maximum interest rate chargeable to individual borrowers to 6 percent. In 1968, section 5-501 was amended to allow a maximum interest rate of 7½ percent, and in 1973 a maximum rate of 8 percent.

[3] At the time of the financing, Garden Corporation was an inactive corporation which had previously been established by Peter Santin Construction Co., Inc., appellant Santin's closely held construction company, and Alfred Stangl, who is not a party to this litigation. Losson Corporation, on the other hand, was established for the specific purpose of avoiding New York's usury provisions.

shareholders intended that the corporations should be merely financing vehicles. Accordingly, the corporations transferred all draws on the mortgage loans, either by check or endorsement, to the partnerships. Moreover, the partnerships received all rental income from and paid all expenses incurred in the construction and operation of the apartment projects.

On their individual federal tax returns, the partners claimed their distributive shares of the net operating losses reported by the partnerships on their information returns. These were disallowed by appellee, the Commissioner of Internal Revenue ("Commissioner"), on the ground that the losses could only be claimed by the corporations.

The Tax Court below held that neither Garden Corporation nor Losson Corporation could be disregarded for federal tax purposes. Noting that the instant case is virtually indistinguishable from *Strong v. Commissioner*, 66 T.C. 12, aff'd on the opinion below, 553 F.2d 94 (2d Cir. 1977), Judge Hall ruled that the individual partners were not entitled to deduct their distributive shares of the net operating losses incurred with respect to the apartment complexes. We agree and reaffirm the holding of the Tax Court in *Strong* that "income from property must be taxed to the corporate owner, and will not be attributed to the shareholders, unless the corporation is a *purely passive dummy* or is used for a tax-avoidance purpose." 66 T.C. at 22. Neither exception to the rule in *Strong* exists here. *Strong v. Comm'r, supra*, at 22-25; see *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436 (1943).

Appellants also argue that the Commissioner's denial of their claimed deductions is an arbitrary and capricious application of Section 482 of the 1954 Internal Revenue Code. Section 482 provides *inter alia* that the Commissioner may apportion deductions between organizations owned or controlled directly or indirectly by the same interests in order to clearly reflect the income of such businesses.[4] Appellants argue that since the partnerships were the taxable entities which financed and built the apartment projects, the individual partners should be entitled to deduct their allocable shares of the operating losses.

This contention has no merit since the record is clear that the Commissioner did not invoke section 482 in denying appellants' deductions. The statutory notices do not mention the statute. Rather, the Commissioner relied on the principle that the corporations, as owners of the property, were the proper parties to claim the deductions. We agree with the Tax Court that there is no

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[4] Section 482, as applicable during the years in question, provided as follows:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses.

reason in this case to depart from the general rule that courts will not look behind the statutory notice in order to ascertain which provisions the Commissioner relied upon in making his determination. *Branerton Corp. v. Comm'r*, 64 T.C. 191, 200 (1975); *Greenberg's Express, Inc. v. Comm'r*, 62 T.C. 324, 327 (1974). We are fortified in this conclusion by the responses of the Commissioner to interrogatories in which he repeatedly denied that his determination had been based on section 482.

The Tax Court allowed the individual partners certain deductions for business expenses which were solely attributable to property owned by the partnerships. Appellee points out that the Tax Court made a mathematical error in calculating Garden Partnership's share of the interest on the purchase obligation paid in 1967 to Sereth Properties, Inc., the seller of the real estate on which the partnership's apartment complex was located. The appropriate deduction is $4,520.82, rather than $2,728.42, which the Tax Court computed.

We find appellants' remaining arguments to be without merit. Accordingly, the decisions of the Tax Court are affirmed in all parts except the case is remanded to the Tax Court so that it may amend its mathematical computation of deductions allowed to appellants in accordance with this opinion.

OAKES, *Circuit Judge* (concurring):

I concur in Judge Mulligan's opinion. The record does not support appellant's contention that the Commissioner in his discretion invoked Section 482 in denying

the deductions.[1] Neither the Commissioner's 30-day letter nor his 90-day letter (statutory Notice of Deficiency) cited any specific provisions of the Code, let alone Section 482. The Commissioner apparently based his decision on the principle that the corporations, as owners of the property, were the proper parties to claim the deductions; his response to interrogatories repeatedly denied a Section 482 allocation and claimed reliance instead on Sections 11, 61, and 63.

Appellants, however, make two troubling points that raise questions about the Commissioner's consistency over time and uniformity of treatment among taxpayers. First, a District Director of the IRS explicitly made a Section 482 allocation between the corporations and partnerships, but *for subsequent tax years* not at issue here. Second, appellants allege that the Commissioner issued at least one private ruling to another party, in a scenario similar to the instant one, allowing the partners, not the corporation, to deduct the losses. To be sure, the IRS states in the introduction to each issue of its Cumulative Bulletin that "[u]npublished rulings will not be relied on, used, or cited as precedents by service personnel in the

[1] Nor can the taxpayer compel the Commissioner to invoke Section 482: "Section 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions." Treas. Reg. §1.482-1(b)(3). The general thrust of the provision, then, is to provide the Commissioner with a sword, not to give taxpayers a shield. Appellants cite *Rubin v. Commissioner*, 429 F.2d 650 (2d Cir. 1970), to support their position that Section 482 should be applied, but the Commissioner in that case had apparently *alternatively relied* on Section 482 in finding deficiencies in the taxpayer's reported income, a factor not present here.

disposition of other cases." Nevertheless, the Supreme Court, in *Hanover Bank v. Commissioner*, 369 U.S. 672 (1962), viewed such rulings as having some precedential value:

> [A]lthough the [taxpayers] are not entitled to rely upon unpublished private rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws. And, because the Commissioner ruled, in letters addressed to taxpayers requesting them, that amortization with reference to a special call price was proper under the statute, we have further evidence that our construction of allowable bond premium amortization is compelled by the language of the statute.

Id. at 686-87 (footnotes omitted).

And there are indications that the IRS itself has relied on such private rulings to determine how to treat other similarly situated taxpayers. *See* K.C. Davis, *Administrative Law of the Seventies* §17.07-5, at 417-18 (1976) [hereinafter cited as Davis] ("*[U]npublished rulings are commonly relied upon by Service personnel in the disposition of other cases* . . . . [T]he evolution of [these] practices and [these] pretenses has in fact produced what is in fact a gigantic fraud, for every issue of the Cumulative Bulletin states falsely that unpublished rulings are not relied on . . . ."') (emphasis in original). It is my view that consistency over time and uniformity of treatment among taxpayers are proper benchmarks from

which to judge IRS actions. *See, e.g., Sirbo Holdings, Inc. v. Commissioner,* 476 F.2d 981, 987 (2d Cir. 1973) ("[T]he Commissioner has a duty of consistency toward similarly situated taxpayers; he cannot properly concede capital gains treatment in one case and, without adequate explanation, dispute it in another having seemingly identical facts which is pending at the same time.") (citations omitted). *See generally* Davis §§17.07-1 to -8. But these appellants have not shown violations of either tenet sufficiently clearly to trigger real doubt as to the validity of the IRS actions here.

APPENDIX B

Tax Court Memorandum Decisions

[CCH Dec. 35,844(M)] John and Norma Ogiony, et al.[1] v. Commissioner.

Docket Nos. 1044-76, 1045-76, 1046-76, 1047-76, 1072-76. T. C. Memo. 1979-32. Filed January 23, 1979. [Appealable, barring stipulation to the contrary, to CA-2.—CCH.]

[*Code Secs. 61, 162, 163, 164, 167, 172 and 482*]

Deductions: Who is the taxpayer: Corporation v. partnership: Business expenses.—Individuals who formed two separate partnerships that conveyed most of their property to two corporations wholly owned by the individuals in order to obtain financing for real estate projects were not entitled to have their corporations disregarded for tax purposes on the ground that they were mere conduits for their partnerships. Thus, the individuals were not entitled to deduct net operating losses incurred regarding property owned by their corporations simply because all the corporations' income and expenses were received and paid by the partnerships. A deduction was allowed for business expenses that were attributable to property actually owned by the partnerships.—CCH.

Ralph J. Gregg, 2110 Main Place Tower, Buffalo, N. Y., for the petitioners. Barry J. Finkelstein, for the respondent.

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[1] Cases of the following petitioners are consolidated herewith for purposes of trial, briefing and opinion: John J. and Gloria Nasca, Docket No. 1045-76; Joseph M. and Nancy Nasca, Docket No. 1046-76; Edward L. and Ruth M. Ogiony, Docket No. 1047-76; and Peter and Enis Santin, Docket No. 1072-76.

Appendix B—Tax Court Memorandum Decisions.

Memorandum Findings of Fact and Opinion

HALL, Judge: Respondent determined the following deficiencies in petitioners' income tax:

Petitioners	*Years*	*Deficiency*
John & Norma Ogiony	1967	$ 1,155.25
	1968	6,124.90
	1969	11,386.00
	1970	12,180.28
	1971	15,590.90
		$46,437.33
John J. & Gloria Nasca	1971	$ 5,760.88
Joseph M. & Nancy Nasca	1971	$ 5,707.90
Edward L. & Ruth M. Ogiony	1967	$ 1,224.56
	1968	6,169.24
	1969	11,519.13
	1970	12,910.59
	1971	16,593.09
		$48,416.61
Peter & Enis Santin	1967	$ 2,379.83
	1968	13,054.69
	1969	9,138.75
	1970	25,622.26
	1971	4,183.37
		$54,378.90

Petitioners (or their wholly-owned corporations) were members of two partnerships, Garden Village Partnership ("Garden Partnership") and Losson Gardens Com-

pany ("Losson Partnership"). The partnerships wanted to develop certain parcels of unimproved real estate; however, due to New York's usury law, the partnerships were unable to obtain financing. Corporations, on the other hand, were exempt from New York's usury law. Petitioners John Ogiony, Edward Ogiony and Peter Santin utilized a corporation, Garden Village Builders, Inc. ("Garden Corporation"), to develop one apartment complex; petitioners John Ogiony, Edward Ogiony, Peter Santin, John Nasca and Joseph Nasca utilized another corporation, Losson Gardens, Inc. ("Losson Corporation"), to develop another apartment complex. In both instances petitioners used a corporate entity in order to avoid New York's usury law. The issues remaining for decision are:

1. Whether Garden Corporation and Losson Corporation may be disregarded for Federal tax purposes; and

2. If the corporations may not be disregarded, whether Garden Partnership and Losson Partnership had any net operating losses with respect to which petitioners are entitled to deductions.

Findings of Fact

Most of the facts have been stipulated by the parties and are found accordingly.

At the time they filed their petition, all petitioners resided in New York State. Petitioners Norma Ogiony, Gloria Nasca, Nancy Nasca, Ruth M. Ogiony and Enis Santin are parties only by virtue of having filed joint returns with their husbands during the years in question.

When we hereafter refer to petitioners, we will be referring to John and Edward Ogiony, John and Joseph Nasca, and Peter Santin.

1. Garden Village.

In 1965, Mr. Alfred Stangl negotiated for and acquired from Sereth Properties, Inc. ("Sereth") an option to purchase a 48.6 acre tract of land at French and Union Roads in the Town of Cheektowaga, New York. Shortly thereafter Peter Santin became associated with Stangl and, on November 1, 1965, Garden Village Builders, Inc., ("Garden Corporation") was formed by Stangl and Peter Santin Construction Co., Inc., Santin's closely held construction company. Garden Corporation adopted a fiscal year ending September 30. Santin and Stangl's initial endeavor—to create a townhouse community—was unsuccessful, however, and in its corporation income tax return for the fiscal year ended September 30, 1966, Garden Corporation reported a loss of $26,307.50 upon abandonment of its townhouse project.

On May 2, 1966, Roxborough Homes Corp. ("Roxborough") acquired a one-third interest in Garden Corporation. John and Edward Ogiony ("the Ogionys") were the principal stockholders and officers of Roxborough. The acquisition by Roxborough of a stock interest in Garden Corporation was incidental to the formation of a joint venture known as "P. Santin, J. & E. Ogiony, A. Stangl—Joint Venture" ("Garden Partnership"). Garden Partnership filed partnership information returns on a calendar year basis. Santin, Stangl and the Ogionys

("the Partners")[2] agreed to build rental apartments on the land on which Stangl had an option. Profit and loss from the Garden Partnership were to be shared equally, the Ogionys and Santin were to provide all funds required, and the land was to be bought in the names of and for the benefit of the Partners, individually, as tenants in common.

In August 1966, Santin, Stangl and the Ogionys exercised the option on the Sereth property. They acquired the property in the following stages:

Date	*Acres*	*Purchase Price*
8/15/66	11 plus	$110,000
8/15/66	8 plus	45,000
3/ 1/67	12 plus	65,000
1/15/68	16 plus	80,000
	48.6	$300,000

In addition to the listed pruchase price, they paid Sereth interest at 5 percent from October 11, 1965, to the date of closing of each purchase. When they purchased 12 acres on March 1, 1967, they paid Sereth interest of $4,505.47 and county and school taxes of $561.42. When they purchased the last parcel on January 15, 1968, they paid Sereth $9,006.42 interest and county and school taxes totaling $956.50. The purchase price, closing costs

[2] Stangl was bought out of the Garden Partnership in 1968; he is not a party to this case. The official name of the partnership was changed to "P. Santin, J. & E. Ogiony—Joint Venture."

and expenses incurred for the land purchase were paid either with checks drawn on the Ogionys' or Santin's personal accounts or by checks drawn on the bank accounts of Garden Partnership.

Although Garden Partnership wished to develop the property, it was unable to obtain a loan because of New York's usury laws. Under section 5-501 of the New York General Obligations Law,[3] the maximum interest rate that could be charged individuals in financial transactions of the type involved in the instant case at that time was 6 percent; anything over 6 percent was usurious. Section 5-501 was amended in 1968 to allow, in effect, a maximum interest rate of 7½ percent, and in 1973 a maximum interest rate of 8 percent. Corporations, however, were not able to interpose a defense of usury. Santin approached Western Savings Bank ("Western"), with which he had dealt for many years, and requested a loan on behalf of Garden Partnership; this request was denied. In essence, Santin was informed that because of a "money crunch" loans at 6 percent interest (the maximum rate allowable for individual and, hence, Garden Partnership) were unavailable; Santin was informed that loans on investment property were limited to loans to corporations.

Since neither the Partners nor Garden Partnership could obtain the financing necessary for the apartment project, the Partners decided to "go the corporate route." The Partners decided to use Garden Corporation,

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[3] N. Y. Gen. Oblig. Law, sec. 5-501 (McKinney 1964).

which was inactive by this time,[4] since Western preferred a corporate borrower which was already in existence to a new "shell" corporation formed for that purpose. In fact, the suggestion that Garden Corporation should be the borrower originated with Mr. Frantzen, an officer at Western, who believed that the Partners were already shareholders of Garden Corporation.[5]

A special meeting of the board of directors of Garden Corporation was held on March 24, 1967. The subject of discussion was the problem of financing the construction of apartments on the tract owned by Garden Partnership. It was reported to the meeting that "the Western Savings Bank was not interested" in advancing the mortgage money to the individuals because of "the going interest rate that could be charged to corporations." The following two motions were passed:

> (1) That the individuals convey to this Corporation a portion of the land held by them as individuals so that the Corporation would be the title owner, which would be done solely for the purpose of obtaining from the Western Savings Bank a $720,000 mortgage for apartment construction on the premises, with interest at the rate of 6½% per annum, which rate could not be obtained by the parties as individuals.

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[4] Although Garden Corporation was inactive, minutes for annual meetings of the shareholders and directors of the corporation were prepared for 1965 through 1978. The minutes for 1970 and 1971 were not signed.

[5] In fact, Stangl, Roxborough and Peter Santin Corporation Company, Inc. were shareholders; Santin and the Ogionys were only indirect shareholders of Garden Corporation.

(2) During the term of the building loan advances under said $720,000 mortgage, the property would continue to remain in the corporate name until such time as the final draw had been obtained by the Corporation and the permanent mortgage was then placed against the said property.

At that time the Corporation would re-convey the subject premises to the respective parties, or their assigns with an assumption of the $720,000 mortgage by the Western Savings Bank, it being understood that this transaction is being done solely for the purpose of obtaining the financing from the Western Savings Bank at the interest rate as requested by them.

That other than this transaction, it was generally agreed that the Corporation was to remain in an inactive status.

It was further agreed that none of the $720,000 proceeds shall in anywise be used by the Corporation for any corporate obligations, but shall be used strictly for the construction of the apartments and pursuant to the terms of the mortgage, and for no other reason.

On the same date, Western issued a commitment letter for a $720,000 mortgage loan to Garden Corporation payable over a 25-year period with interest at 6½ percent per annum, the purpose of the loan being to finance nine eight-unit brick apartments and 72 garages on two parcels totaling 4.93 acres of the tract the Partners had acquired from Sereth. On August 11, 1967, the Partners

conveyed their undivided interests in the two parcels of land described in the commitment letter to Garden Corporation. On the same day Garden Corporation executed and recorded a mortgage for $720,000 to Western.

During the ensuing four years, the Partners deeded to Garden Corporation the various parcels of land and all improvements thereon and they executed various mortgages to Western covering all fixtures permanently attached to the property. The Partners believed that they owned all fixtures not permanently attached. A summary of the dates of transfer, the acreage transferred by the Partners to Garden Corporation, and the amount of each mortgage is set forth below:

Date	*Acres*	*Mortgage*	*Interest Rate*
8/11/67	4.93	$ 720,000	6½%
9/20/68	4.03	600,000[6]	7½%
4/10/69	3.21	740,000	8 %
5/10/70	1.41	345,000	9½%
12/14/70	1.39	489,000	9½%
6/ 1/71	2.23	585,000	8¾%
	17.20	$3,479,000[7]	

On August 1, 1972, Western issued a commitment letter to Garden Corporation for a conventional permanent consolidation of all of the above loans in the amount of $3,600,000 at 8.2% interest.

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[6] The amount of this mortgage was increased to $650,000 at 7¾% interest by an instrument executed April 10, 1969.

[7] The total was increased to $3,529,400 due to the increase explained in note 6 *supra*.

Although Garden Corporation was the mortgagee of record for all mortgage loans obtained from Western, on two occasions Garden Corporation transferred title of a portion of the land which it owned back to the Partners. On January 2, 1968, Garden Corporation deeded 4.93 acres back to the Partners; the land was reconveyed to Garden Corporation on January 23, 1968. On December 17, 1968, Garden Corporation conveyed back title to the same 4.93 acres; this same parcel was reconveyed to Garden Corporation on April 10, 1969. Garden Corporation owned the following percentages of the land during the years listed:

Year	*Percentage Owned*
1967	6.0%
1968	11.5%
1969	20.7%
1970	27.0%
1971	30.6%

Although all the loans from Western were made to Garden Corporation, the corporation's shareholders intended at all times that Garden Corporation would be nothing more than a financing vehicle. Santin, Stangl and the Ogionys did not intend to have Garden Corporation take over the apartment project; rather, they viewed the development project as strictly a personal investment.[8] All draws on the mortgage loans from Western

[8] In addition, the Partners loaned their personal funds to Garden Partnership; Partners' loans outstanding as of December 31, 1971, totaled $166,411.94.

were transferred by Garden Corporation, either by check or by endorsement, to the construction account of Garden Partnership. All rental income from the apartments was deposited in Garden Partnership's rental account; the leases listed Garden Partnerhip as lessor. However, the Partners obtained the benefit of financing from using Garden Corporation in this transaction.

Apartment houses were built on the land. The construction and related activities were under the supervision of Santin and the Ogionys. The individual partners—as well as their suppliers—viewed the liabilities incurred in the course of the construction project as the individuals' personal liabilities. All of the expenses[9] incurred in connection with the development and operation of the Garden Village Apartments were paid either by the Partners or by Garden Partnership. Income received and expenses incurred by the Partners and Garden Partnership during the years in issue were as follows:

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[9] The parties set forth in the Stipulation of Facts an exhaustive catalog of the expenses incurred by Garden Partnership. *All* expenses connected with this real estate project, as well as any other expenses of Garden Partnership on its own behalf, were paid by the partnership. Expenses incurred by the partnership on its own behalf included legal and accounting fees, telephone charges, bank service charges, office supplies, travel expenses, contributions and postage.

Year	*Amount*
1967	
INCOME	none
EXPENSES	
Interest	
Sereth Properties	$ 4,809.38
Western Savings	2,902.57
Manufacturers' & Traders' Trust	2,957.55
Realty Taxes[10]	1,744.24
Telephone	20.09
Bank Service Charges	1.00
Advertising	1,314.70
Office Expense	113.52
1/1/68 thru 9/30/68[11]	
INCOME	
Rent	$45,061.00
Common land sale	4,528.88
EXPENSES	
Realty Taxes	7,738.35
Interest	44,905.23
Commission	5,875.60
Telephone	403.13
Utilities	2,825.13
Supplies	157.96
Repairs	294.25
Maintenance	2,209.78

[10] Real estate taxes paid of $1,744.24 represent tax on 20 acres of undeveloped land for the entire year and 12 acres for 5/6 of the year. This equals a tax rate of approximately 58.14 per acre of undeveloped land per year. Accordingly, the real estate taxes for 48.6 acres of undeveloped land would have been $2,825.67. There is no evidence in the record that taxes on unimproved real estate increased during the years in issue.

[11] Garden Partnership filed partnership information returns for the period 1/1/68 thru 9/30/68 and 10/1/68 thru 12/31/68 because Stangl left the Partnership on September 30, 1968.

Year	*Amount*
Insurance	2,089.65
Office Supplies[12]	301.36
Wages	1,187.50
Legal and Accounting	425.00
Miscellaneous	995.89
Advertising	484.08
Equipment Rental	81.32
Payroll Taxes	52.25
10/1/68 thru 12/31/68	
INCOME	
Rent	$33,350.00
EXPENSES	
Interest	23,080.02
Accounting Fee	150.00
Payroll Taxes	93.95
Commissions	2,340.50
Telephone	141.31
Utilities	2,501.33
Maintenance	2,136.45
Wages	1,348.33
Miscellaneous	207.36
Insurance	1,203.96
Supplies	149.41
1969	
INCOME	
Rental Income	$243,142.56
Machine Income[13]	803.00
Other Income	375.84

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[12] An office was maintained by Garden Partnership at the apartment complex.

[13] Although Garden Partnership reported income with respect to its washers and dryers, there is no evidence in the record as to costs associated with, or the basis of, such machines.

Year	*Amount*
EXPENSES	
Interest	115,635.27
Real Estate Taxes	22,445.73
Commissions	14,807.00
Wages	5,200.00
Payroll Taxes	427.02
Insurance	6,087.70
Legal Fees	131.00
Accounting	1,800.00
Telephone	809.22
Utilities—Gas	10,905.73
—Electric	5,513.04
—Water	3,231.92
Maintenance	16,903.95
Pool Expense	3,510.25
Office Expense	1,036.97
Gasoline and Oil	342.55
Miscellaneous Expenses	1,472.12
Advertising	571.20
Dues & Subscriptions	250.00
Repairs	215.52
Bank Service Charges	36.98
Amortization of Mortgage Costs	690.51
1970	
INCOME	
Rental Income	$398,421.44
Machine Income	3,155.55
EXPENSES	
Interest	178,322.77
Real Estate Taxes	44,084.11
Commissions	15,578.75
Wages	16,095.05
Payroll Taxes	975.68
Insurance	7,687.78
Legal and Accounting	1,638.40
Telephone	1,322.57

Year	*Amount*
Utilities—Gas	18,499.56
—Electric	10,883.19
—Water	7,258.46
Maintenance	14,775.15
Pool Expense	1,661.31
Gasoline and Oil	1,200.30
Miscellaneous Expense	3,438.83
Advertising	281.25
Dues & Subscriptions	95.00
Repairs	1,503.20
Bank Service Charges	67.10
Amortization of Mortgage Costs	1,522.38
Office Supplies	313.08
Supplies	1,992.72
Contributions	375.00
Travel Expense	114.00
1971	
INCOME	
Rental	$481,405.99
Interest	609.28
Other	7,353.09
EXPENSES	
Interest[14]	$234,138.68
Real Estate Taxes	70,380.76
Commissions	18,330.00
Wages	23,883.49
Payroll Taxes	1,687.70
Insurance	7,369.06

[14] Of this interest, $916.65 was paid to Peter Santin Construction Company, Inc., $916.65 was paid to Roxborough Homes, Inc., and $568.75 was paid to Manufacturers' and Traders' Trust Company ("Manufacturers' "). Garden Partnership had borrowed from Peter Santin Construction Company, Inc. and Roxborough. Garden Corporation had borrowed $30,000 from Manufacturers' as part of its townhouse project.

Year	*Amount*
Legal and Accounting	2,775.00
Telephone	1,518.66
Utilities—Gas	25,209.46
—Electric	13,186.34
—Water	8,864.98
Maintenance	11,819.53
Pool Expense	424.31
Gasoline and Oil	1,293.25
Miscellaneous	1,255.32
Advertising	585.49
Dues and Subscriptions	96.75
Repairs	7,504.10
Bank Service Charges	80.41
Amortization Mortgage Cost	1,993.43
Office Supplies	628.23
Supplies	10,020.11
Contributions	1,152.50
Postage	70.00

In addition to the expenses listed above, Garden Partnership purchased various assets, including equipment, and machines, which it used in connection with its own activities as well as the operation of the apartment project. The only assets for which title was transferred to Garden Corporation were parcels of land and improvements thereon. During the years in issue, Garden Partnership claimed depreciation on assets as follows:

Year	*Assets*	*Depreciation*
1967	None	None
1/ 1/68—9/30/68	Buildings	$ 9,706.75
	Snowblower and Lawnmower	27.79
	Adding Machine	8.09
	Garbage Containers	48.13
	Office Furniture	4.15

Year	*Assets*	*Depreciation*
	Rugs	2,118.12
	Appliances	1,487.88
	Hot Water Tanks	135.00
	Parking Lots	1,751.40
10/ 1/68— 12/31/68	Buildings	9,561.15
	Snowblowers and Lawnmowers	27.79
	Adding Machine	8.09
	Garbage Containers	73.13
	Office Furniture	4.15
	Car Radio	58.05
	Office Building & Warehouse	180.62
	Rugs	1,985.72
	Appliances	1,413.49
	Hot Water Tanks	128.25
	Parking Lots	1,663.83
1969	Buildings	66,962.96
	Snowblowers and Lawnmowers	111.15
	Adding Machine	32.37
	Garbage Containers	328.54
	Office Furniture	16.61
	Car Radio	232.21
	Office Furniture	7.80
	Office Building & Warehouse	722.48
	Rugs	17,391.08
	Appliances	11,417.56
	Hot Water Tanks	1,270.36
	Parking Lots	10,023.81
1970	Buildings	100,328.96
	Rugs	22,609.82
	Appliances	16,990.99
	Hot Water Tanks	2,059.93
	Parking Lots	12,993.59
	Additions	8,286.21

Appendix B—Tax Court Memorandum Decisions.

Year	*Assets*	*Depreciation*
	Recreation Building	3,022.28
	Snowblowers and Lawnmowers	111.15
	Adding Machine	32.37
	Garbage Containers	436.66
	Office Furniture	56.35
	Car Radio	232.21
	Office Building & Warehouse	722.48
	Copy Machine	16.85
	Typewriter	4.71
	Litter Vacuum	22.55
	Pool Table-Rec. Hall	10.50
	Dodge Truck[15]	272.26
	Dumpsters	108.29
1971	Buildings	84,090.06
	Rugs	18,279.25
	Appliances	14,595.60
	Hot Water Tanks	1,842.31
	Parking Lots	9,503.38
	Additions	7,026.99
	Recreation Building	5,863.83
	Snowblowers and Lawnmowers	111.15
	Adding Machine	32.37
	Garbage Containers	436.66
	Office Furniture	56.35
	Car Radio	232.21
	Office Building & Warehouse	722.48
	Copy Machine	22.47
	Typewriter	9.42
	Litter Vacuum	45.10
	Pool Table-Rec. Hall	42.00
	Dodge Truck	1,089.06
	Dumpsters	275.87
	Furniture-model Apartments	282.75
	Sign	13.30

[15] The truck was used for maintenance of the apartment complex grounds.

During the years in issue, Garden Corporation reported no income, and it claimed deductions for expenses as follows:

Fiscal Year Ended	*Expense*	*Amount*
9/30/67	Bank Charges	$ 2.00
	Other (unlisted)	22.50
9/30/68	Bank Charges	10.00
	Franchise Taxes	25.00
	Accounting Fees	125.00
9/30/69	Bank Charges	23.20
	Franchise Taxes	81.25
9/30/70	Bank Charges	17.11
	Franchise Tax	100.00
9/30/71	Bank Charges	.50
	Franchise Tax	118.75

In his statutory notice, respondent disallowed the distributive shares of operating losses claimed by the individual partners for 1967 through 1971 on the ground that the losses belonged to Garden Corporation. Respondent did not cite any section of the Internal Revenue Code as the basis for his determination in the notices.

2. *Losson Gardens*

Losson Gardens Company ("Losson Partnership") was a joint venture organized in 1969 by Peter Santin Construction Co., Inc., Roxborough Homes Corp. and John and Joseph Nasca. The partnership adopted a fiscal year ending September 30.[16] The purpose of this partnership was to purchase land and build apartments on Losson Road in Cheektowaga. On July 1, 1969, Losson Partner-

[16] The sole year at issue here is the fiscal year ended September 30, 1971.

ship purchased 36.02 acres of land on the north side of Losson Road. On January 6, 1971, Losson Partnership acquired a contiguous parcel of land 3 acres from a local school district.

Losson Gardens, Inc. ("Losson Corporation") was incorporated on August 12, 1969. The partners in Losson Partnership formed the corporation solely to satisfy bank requirements for obtaining a loan. Losson Partnership had to transfer title of parcels of land which it wished to develop to the corporation in order to receive financing. On June 10, 1968, Losson Partnership conveyed 2.74 acres to Losson Corporation; on August 24, 1971, 3.15 acres were conveyed by the partnership to the corporation; and on October 21, 1971, an additional 2.82 acres were conveyed to the corporation. Losson Corporation owned 7.9% of the land in 1971.

Mortgages on the property conveyed by Losson Partnership to Losson Corporation were obtained from Western. The following mortgage loans were received by Losson Corporation from Western:

Date	*Amount*
6/12/70	$530,000
8/24/71	672,000
10/20/71	467,000

All draws received from Western were in the form of checks payable to Losson Corporation. These checks were either deposited in Losson Corporation's checking account, with checks being drawn against these deposits to Losson Partnership, or the checks were endorsed over to the partnership and deposited in its construction account.

Title to the entire tract, other than portions conveyed to Losson Corporation, was retained by Losson Partnership during the year in issue.

All of the expenses incurred in connection with development of the Losson Garden Apartments, and all rents therefrom, were in the name of Losson Partnership. The partnership also incurred its own expenses.[17] The expenses and income of Losson Partnership for its fiscal year ended September 30, 1971, were as follows:

Income

Rental Income	$43,750.22
Misc. Receipts	1,006.90

Expenses

Interest Cost	64,495.55
Real Estate Taxes	3,882.88
Amortization of Mortage Fees	218.95
Rental Commissions	6,906.49
Office Expenses	590.30
Utilities & Services	5,732.32
Supplies, Repairs & Maintenance	3,390.03
Insurances	2,589.25

In its partnership information return for its fiscal year ended September 30, 1971, Losson Partnership claimed depreciation deductions as follows:

Depreciation of Buildings	$14,642.16
Depreciation of Furniture and Fixtures	5,593.06
Depreciation of Parking Lot	1,122.82
Depreciation of Machinery and Equipment	199.50

[17] Losson Partnership's expenses were the same as expenses of Garden Partnership.

On their returns, the Ogionys, the Nascas and Santin claimed distributive shares of the net operating loss which Losson Partnership had reported for its fiscal year ended September 30, 1971. In the statutory notices respondent disallowed these claims on the grounds that the losses belonged to Losson Corporation. Respondent did not cite any section of the Internal Revenue Code in his statutory notices as the basis for his determinations.

Opinion

The first issue for decision is whether Garden Corporation and Losson Corporation may be disregarded for Federal tax purposes. Petitioners' position is generally that the corporations should be ignored. Respondent, on the other hand, contends that we should follow our recent decision in *Strong v. Commissioner* [Dec. 33,748], 66 T. C. 12 (1976), affd. without published opinion [77-1 USTC ¶9240] (2d Cir. Feb. 14, 1977), and recognize the corporations as owners of the property transferred to them. We agree with respondent.

The facts in this case are virtually identical to those presented in *Strong, supra.* Economic conditions pushed the market rate of interest above the New York usury law limit of 6 percent. Petitioners (or their wholly-owned corporations) were members of two partnerships, Garden Partnership and Losson Partnership. Petitioners desired to improve certain properties with apartment buildings. Due to New York's usury law they were unable to obtain financing in their individual capacity or through their partnerships. Corporations, however, are unable to interpose a defense of usury in New York. Accordingly, peti-

tioners used two corporations, Garden Corporation and Losson Corporation, as corporate borrowers in order to obtain the funds which the partnerships needed to construct the apartment building.

As a precondition to obtaining the desired mortgage construction loans, the corporations had to own the property which was to be developed. For most of the time during the years in question, title to the developed portions of the land remained in the corporations. The partnerships collected all rent and paid all expenses connected with the operation of the apartment complexes; the partnerships also retained title to some undeveloped land.[18] On their partnership information returns the partnerships reported the rent as income and deducted all expenses related to the apartment complexes, including interest, taxes, depreciation, wages, etc. Petitioners then claimed net operating losses in the amounts of their individual shares of the partnerships' reported losses.[19] Respondent determined that *all income and deductions* properly belonged to the corporations, not the partnerships, and respondent disallowed the claimed net operating losses.

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[18] Neither party emphasized that Santin and the Ogionys, not Garden Partnership, acquired the tract from Sereth. For the purpose of determining Garden Partnership's net operating losses during the years in issue, we have treated the partnership as the owner of the property not transferred to Garden Corporation.

[19] In fact petitioners John Ogiony, Edward Ogiony and Peter Santin were *not* partners in Losson Partnership; their wholly-owned corporations were partners. Respondent, however, did not base his determination on this fact, and respondent presented no argument that these individuals were not entitled to the claimed deductions on these grounds. Accordingly, for purposes of this opinion we have treated these individuals as partners in the Losson Partnership.

Petitioners present three arguments as the basis of their contention that the corporations should be disregarded for tax purposes. They contend, first, that *Strong v. Commissioner, supra,* was wrongly decided; second, that the corporations were their agent or nominee and, accordingly, should be disregarded; and, third, that since all income was received by and expenses of the apartment complexes were paid by the partnerships, they are entitled to the net operating losses.

As to petitioner's first contention, that *Strong* was wrongly decided, we disagree. *Strong* is a reviewed opinion which was approved without dissent. We follow that decision here. See also *Collins v. United States,* 386 F. Supp. 17 (S. D. Ga. 1974), affd. per curiam 514 F. 2d 1282 (5th Cir. 1975).

Petitioners' second contention is that the corporations were merely their agents or nominees. Although their brief is not clear on this point, petitioners appear to argue that the corporations were, at best, mere conduits for the activities of the partnerships. But it has been held by the Supreme Court that a taxpayer who utilizes, and obtains the economic benefit of, the corporate form may not evade the tax consequences thereof by the characterization of the corporation as merely an agent. *Moline Properties v. Commissioner* [43-1 USTC ¶9464] 319 U. S. 436 (1943); *National Carbide Corp. v. Commissioner* [49-1 USTC ¶9223], 336 U. S. 422 (1949).[20] Similar-

[20] See *Jones v. Commissioner* [Dec. 35,510], T. C. Memo. 1978-446 (November 7, 1978), 37 T. C. M. —, 47 P-H Memo. T. C. par. 78,446 (1978).

ly, in *Strong v. Commissioner, supra,* we specifically rejected the argument that the corporation was "a mere tool or conduit." 66 T. C. at 21. Our determination that *Strong* is controlling here requires us to reject petitioners' contention that the corporations herein be treated as mere nominees.

Petitioners' third contention is that they are entitled to the net operating losses since all rental income was received by and all expenses of the apartment complex were paid by the partnerships. We recently considered these arguments in another context in *Klausner v. Commissioner* [Dec. 35,459(M)], T. C. Memo. 1978-405 (October 11, 1978), 37 T. C. M. 1688, 47 P-H Memo. T. C. ¶78,405 (1978). In *Klausner,* on similar facts, respondent determined that rents received by the taxpayers constituted dividends to them from their corporation. We held that the corporation lacked earnings and profits and, hence, that the rents could not be treated as dividends.[21] We also held that the rents

> should be treated as paid to the Corporation and used by it to pay corporate expenses. At least to the extent of expenses paid by the shareholder, the cash received should be treated as a reimbursement by the Corporation of an advance made by the shareholder. *** [The excess of the taxpayer's expenditures over rent received should be] treated as a contribution to the capital of the Corporation and as being at least part of the basis for [the tax-

[21] Although respondent did not make such a determination here, the same result would occur, since both corporations herein have always operated at a loss.

payer's] interest in the Corporation ***. In view of the foregoing, we conclude that none of the [rent] should be treated as a dividend to [the taxpayer] during 1973. By the same token, the excess amount of expenses *** should not be treated as a loss ***.

The next issue is whether the partnerships had net operating losses with respect to which petitioners are entitled to deductions. Petitioners contend, first, that they are entitled to all their claimed deductions since respondent's determinations were an arbitrary and capricious application of section 482. Second, petitioners contend that respondent has issued private letter rulings allowing other taxpayers the deductions petitioners claim here. Finally, petitioners contend that they are entitled to some of the deductions which respondent determined were the corporations'. The basis for petitioners' final position is that not all of the partnerships' property was transferred to the corporations. Although we disagree with petitioners' first two contentions, we agree with their final contention in part.

Petitioners' first contention, that respondent's determinations were an arbitrary application of section 482, is without merit since respondent's determination in this case did *not* rest on section 482. Rather, respondent's determinations were based on the fact that the corporations were the legal owners of the apartment complexes and, hence, should report all income and deductions with respect thereto. Petitioners were well aware of this since their requests for admissions that section 482 was the basis of respondent's determinations were repeatedly denied. Nevertheless, petitioners ask us to look "behind"

the statutory notices issued to them; they stress that prior correspondence from respondent indicated that respondent was relying on section 482. It is well established, however, that this Court generally will not look behind the statutory notice. *Greenberg's Express, Inc. v. Commissioner* [Dec. 32,640], 62 T. C. 324, 327 (1974); *Branerton Corp. v. Commissioner* [Dec. 33,178], 64 T. C. 191, 200 (1975). We see no reason to depart from that practice here.

Petitioners' second contention, that they are entitled to rely on private letter rulings issued to other taxpayers, is equally meritless. It is well settled that "where the Commissioner has issued a private ruling to one taxpayer, another taxpayer (who has not received a ruling) may not rely on the holding in the issued ruling so as to require that he be given the same treatment that the first taxpayer was accorded." *Teichgraber v. Commissioner* [Dec. 33,274], 64 T. C. 453, 456 (1975); *Tennessee Natural Gas Lines, Inc. and Subsidiary v. Commissioner* [Dec. 35,486], 71 T. C. No. 7 (October 30, 1978). No exception to this rule is applicable here. See *International Business Machines Corp. v. United States* [65-1 USTC ¶15,629], 343 F. 2d 914 (Ct. Cl. 1965). Moreover, there is no evidence that petitioners *relied* on these private rulings.

Petitioners' final contention is that they are entitled to some of the deductions allocated by respondent to the corporations since not all of the partnerships' properties were transferred to the corporations. The questions petitioners have raised are purely factual, and the burden of proof is on them. *Welch v. Helvering* [3 USTC ¶1164],

290 U. S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure.

Generally, to be deductible an expense must be incurred in a taxpayer's own trade or business. *Interstate Transit Lines v. Commissioner* [43-1 USTC ¶9486], 319 U. S. 590 (1943); *Columbian Rope Co. v. Commissioner* [Dec. 26,900], 42 T. C. 800, 815 (1964). In this case, petitioners contend that they are entitled to deduct all the expenses they paid in connection with operation of the apartment complexes. However, we have already concluded that the corporations were the proper parties to include the rents as income. Consequently, only the corporations are entitled to deduct expenses related to the production of this rental income. Respondent disallowed the partnerships' claimed deductions solely on the grounds that the corporations, as owners of the property, were the proper parties to claim the deductions. On brief, respondent notes that "respondent's position in this case is limited to periods of actual corporate ownership of the property involved."

Turning to the specific expenses which the partnerships claimed were deductible during the years in issue, we conclude that these can be separated into several classifications: (1) items deductible only by the corporations; (2) items deductible only by the partnerships; (3) real estate taxes; (4) interest; and (5) depreciation.

1. Items deductible only by the corporations. In light of all the evidence in this case, we conclude that the following expenses were solely related to the operation of the apartment complexes and, accordingly, must be

deducted by the corporations for all the years in issue: commissions, wages, payroll taxes, insurance, utilities (except telephones), maintenance (listed as supplies, repairs and maintenance by Losson Partnership), pool expense, gasoline & oil, miscellaneous, advertising, dues and subscriptions, repairs, amortization of mortgage costs, and supplies (except office supplies). Although the corporations transferred some of their property back to the partnerships for brief periods in 1968 and 1969, we must deny deductions for these expenses in their entirety for all the years at issue. Deductions are a matter of legislative grace, *New Colonial Ice Co., Inc. v. Helvering* [4 USTC ¶1292], 292 U. S. 435 (1934), and petitioners bear the burden of proving that they are entitled to their claimed deductions. *Welch v. Helvering* [3 USTC ¶1164], 290 U. S. 111 (1933); *Rockwell v. Commissioner* [75-1 USTC ¶9324], 512 F. 2d 882 (9th Cir. 1975), rehearing denied June 13, 1975, cert. denied 423 U. S. 1015 (1975). Respondent does not contend that petitioners are not entitled to the deductions for the periods when they owned the property. Petitioners, however, have failed to present us with *any* means to allocate these expenses for the periods that the partnerships owned a portion of the developed property. Accordingly, they have failed to carry their burden of persuasion, and we must deny the claimed deductions.

2. *Items deductible only by the partnerships.* In light of all the evidence presented, we conclude that petitioners have carried their burden of proving that the following expenses of the partnerships are deductible by them: legal and accounting, telephone, bank service

charges, office supplies and office expenses, travel expenses, contributions and postage. Respondent has not challenged these claimed deductions on *any* other grounds, including substantiation of the claimed deductions.

3. Real estate taxes. Only the owner of property may deduct real estate taxes. Section 1.164-6(a), Income Tax Regs. We have found that the partnerships paid real estate taxes as follows:

Year	Partnership	Taxes
1967	Garden Partnership . . .	$ 1,744.24
1968	Garden Partnership . . .	7,738.35
1969	Garden Partnership . . .	22,445.73
1970	Garden Partnership . . .	44,084.11
1971	Garden Partnership . . .	70,380.76
1971	Losson Partnership. . . .	3,882.88

The partnerships paid the real estate taxes on the entire tracts, including the lands (and improvements thereon) transferred to the corporations. We concluded that the corporations owned the percentages of the tracts as follows:

Year	Corporation	Percentage Owned[22]
1967	Garden Corporation.	6.0%
1968	Garden Corporation	11.5%
1969	Garden Corporation	20.7%
1970	Garden Corporation	27.0%
1971	Garden Corporation	30.6%
1971	Losson Corporation.	7.9%

[22] For example, if 5 percent of a given piece of land was transferred on July 1 of a given year, the corporation would own 5 percent of the land for 50 percent of the year, or 2.5 percent of the land for the entire year.

The remainder of each tract, for which the partnerships paid real estate taxes, were owned by the partnerships.

At first blush, it appears that we should simply allocate real estate taxes paid on the basis of percentage ownership of the land; *i.e.*, since Garden Partnership owned 94 percent of the land in 1967, it should be entitled to deduct 94 percent of the real estate taxes. The problem with this appproach, however, is that it does not recognize that the portion of the land owned by the corporations was developed and, hence, taxed at a higher rate. Garden Partnership is entitled to deduct the real estate tax on the undeveloped portion of the property. We do know, however, that Garden Partnership's property was subject to real estate taxes of $58.14 per acre in its undeveloped state. The total tax on 48.6 acres of undeveloped land would have been $2,825.67 in 1967. Since petitioners have not presented any evidence proving that real estate taxes increased during the years in issue, we conclude, on the basis of the burden of proof, that this amount ($2,825.67) represents the real estate tax on the entire tract in its undeveloped state during the years in issue. Accordingly, Garden Partnership is entitled to real estate tax deductions during the years in issue as follows:

Year	Deduction
1967	$1,639.59
1968	2,500.72
1969	2,240.76
1970	2,062.74
1971	1,961.02

As to the tract of land owned by Losson Partnership and Losson Corporation, we have no evidence of the real estate taxes on that land in its undeveloped state. We know, however, that Losson Partnership owned 92.1 percent of the 36-plus acres of the tract. We also know that Garden Partnership paid $58.14 tax per acre of undeveloped land. Making an approximation, *Cohan v. Commissioner* [2 USTC ¶489], 39 F. 2d 540, 544 (2d Cir. 1930), we conclude that real estate taxes on the entire tract in its undeveloped state were $2,093 and, accordingly, Losson Partnership is entitled to deduct $1,927.65.

4. Interest. Interest is generally deductible. Section 163. The taxpayer, however, must own the property subject to a mortgage to deduct mortgage interest. Section 1.163-1(b), Income Tax Regs. In this case, with respect to the mortgages obtained by Garden Corporation and Losson Corporation on the land which the corporations developed, petitioners (and their partnerships) were not owners of the property. With the exception of interest paid by Garden Partnership in 1967 and 1971, petitioners have presented no evidence establishing that either partnership paid interest to anyone other than Western.[23] We conclude that petitioners have failed to carry their burden of proving that they are entitled to any interest deductions with respect to payments by

[23] We lack any means to allocate interest deductions to petitioners for the periods in 1968 and 1969 in which they owned some of the developed property.

Garden Partnership in 1968,[24] 1969 and 1970, and with respect to interest payments by Losson Partnership in 1971.

As to Garden Partnership's interest payments in 1967 and 1971, in 1967 Garden Partnership paid Western $2,902.57, Sereth $4,809.38,[25] and Manufacturers' and Traders' Trust Company ("Manufacturers") $2,957.55. The interest paid to Western and Manufacturers is not deductible, since both obligations were corporate obligations.[26] The interest paid Sereth in 1967 was on the obligation arising from the purchase of the original 32 acres. We held, above, that Garden Partnership owned a total of 94 percent of that property during 1967, and, correspondingly, Garden Partnership is entitled to deduct 94 percent of the interest paid to Sereth in that year, or a total of $2,728.42. In 1971 Garden Partnership

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[24] In 1968 the Partners paid Sereth interest of $9,006.42 in connection with the purchase of 16 acres of land. This interest, at 5 percent from the date the option was obtained to the date of closing, was part of the cost of acquisition of the property. Such interest is not deductible but, rather, is added to their basis in the property. *Joell Company v. Commissioner* [Dec. 11,057], 41 B. T. A. 825, 827 (1940); *Goddard v. Commissioner* [Dec. 25,445(M)], 21 T. C. M. 419, 31 P-H Memo. T. C. par. 62,083 (1962).

[25] This does not include interest of $4,505.47 paid in connection with the acquisition of 12 acres from Sereth in 1967 which must be added to the Partners' basis in the property. See note 24 *supra*.

[26] When Garden Corporation attempted to construct townhouses in 1965-1966, it borrowed $30,000 from Manufacturers.

paid interest of $916.65 to Peter Santin Construction Company, Inc., $916.65 to Roxborough Homes, Inc., and $568.75 to Manufacturers. The remaining interest was apparently paid to Western. For reasons discussed above, Garden Partnership is not entitled to the claimed interest deduction for the interest paid to Western and Manufacturers, but the partnership is entitled to deduct the interest paid to Peter Santin Construction Company, Inc. and Roxborough Homes, Inc.[27]

5. Depreciation. Section 167 allows a deduction for depreciation; in general, only the holder of an economic interest in property may deduct depreciation. See *Hunter v. Commissioner* [Dec. 28,025], 46 T. C. 477, 489-490 (1966). In this case, the partnerships claimed depreciation deductions for many assets, including improvements on land which had been transferred to the corporations. We conclude that the partnerships are not entitled to depreciation deductions for any of the buildings (including the office building, warehouse, and recreation buildings) or the fixtures[28] attached thereto, including

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[27] We note, again, that respondent presented no reason for disallowing this interest deduction other than the argument that Garden Corporation was liable on the indebtedness. We found as a fact that Garden Partnership borrowed from Peter Santin Construction Company, Inc. and Roxborough Homes, Inc.

[28] Losson Partnership claimed a depreciation deduction for "furniture and fixtures" in 1971. This deduction is disallowed in its entirety, since petitioners have not proved what portion, if any, of the claimed deduction was allocable to furniture.

rugs, appliances, and hot water tanks.[29] We further hold that the partnerships are not entitled to deduct depreciation on the parking lots, since petitioners have failed to carry their burden of proving that the land underlying the parking lots was not transferred to the corporations.[30] The partnerships are entitled to deduct claimed depreciation on the following assets:[31]

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[29] Under New York law, fixtures "are articles which were personalty but which by being annexed to realty are regarded as a part thereof." *In re Lido Beach Sewage Collection District*, 40 Misc. 2d 384, 243 N. Y. S. 2d 223, 225 (Nassau County Ct. 1963). Petitioners have failed to prove that these assets—rugs, appliances, hot water tanks—were not annexed to the buildings.

[30] We lack any means to allocate depreciation deductions to petitioners for the periods in 1968 and 1969 in which they owned some of the developed property.

[31] Again, we note that respondent disallowed the claimed depreciation deductions only on grounds of ownership—we have considered no other reasons for disallowing the claimed deductions.

Appendix B—Tax Court Memorandum Decisions.

Year	Partnership	Assets
1968	Garden Partnership	snowblower and lawnmower adding machine garbage containers office furniture car radio
1969	Garden Partnership	same as 1968
1970	Garden Partnership	same as 1969, plus copy machine typewriter litter vacuum pool table Dodge truck dumpsters
1971	Garden Partnership	same as 1970, plus furniture—model apartment sign
1971	Losson Partnership	machinery and equipment

Decision will be entered under Rule 155.

APPENDIX C

Petition for Rehearing

UNITED STATES COURT OF APPEALS
Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of May, one thousand nine hundred and eighty.

Present: HON. WILLIAM H. MULLIGAN,
HON. JAMES L. OAKES, *Circuit Judges.*

United States Court of Appeals
Second Circuit
Filed
May 7 1980
A. Daniel Fusaro, Clerk

JOHN & NORMA OGIONY,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

JOHN J. NASCA and GLORIA NASCA,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

JOSEPH M. NASCA and NANCY NASCA,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

Appendix C—Petition for Rehearing.

EDWARD L. OGIONY and RUTH M. OGIONY,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE.

PETER SANTIN and ENIS SANTIN,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

79-4147
79-4149
79-4151
79-4153
79-4155

A petition for a rehearing having been filed herein by counsel for the petitioners,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO
Clerk.

APPENDIX D

Internal Revenue Code of 1954 and Treasury Regulations on Income Tax (1954 Code)

Sec. 482 Allocation of Income and Deductions Among Taxpayers.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

REGULATIONS

§1.482-1 Allocation of income and deductions among taxpayers.—

(b) *Scope and purpose.* (1) The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the tax-

able income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, *the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer.* The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

* * *

(d) *Method of allocation.* (1) *The method of allocating, apportioning, or distributing income, deductions credits, and allowances to be used by the district director in any case, including the form of the adjustments and the character and source of amounts allocated, shall be determined with reference to the substance of the particular transactions or arrangements which result in the avoidance of taxes or the failure to clearly reflect income.* The appropriate adjustments may take the form of an increase or decrease in gross income, increase or decrease in deductions (including depreciation), increase or decrease in basis of assets (including inventory) or any other adjustment which may be appropriate under the circumstances. See §1.482-2 for specific rules relating to methods of allocation in the case of several types of business transactions.

(2) *Whenever the district director makes adjustments to the income of one member of a group of controlled taxpayers* (such adjustments being referred to in this paragraph as "primary" adjustments) *he shall also make appropriate correlative adjustments to the income of any other member of the group involved in the allocation.* The correlative adjustment shall actually be made if the U. S. income tax liability of the other member would be affected for any pending taxable year. Thus, if the district director makes an allocation of income, he shall not only increase the income of one member of the group, but shall decrease the income of the other member if such adjustment would have an effect on the U. S. income tax liability of the other member for any pending taxable year. For the purposes of this subparagraph, a "pending taxable year" is any taxable year with respect to which the U. S. income tax return of the other member has been filed by the time the allocation is made, and with respect to which a credit or refund is not barred by the operation of any law or rule of law. If a correlative adjustment is not actually made because it would have no affect on the U. S. income tax liability of the other member involved in the allocation for any pending taxable year, such adjustment shall nevertheless be deemed to have been made for the purpose of determining the U. S. income tax liability of such member for a later taxable year, or for the purposes of determining the U. S. income tax liability of any person for any taxable year. *The district director shall furnish to the taxpayer with respect to which the primary adjustment is made a written statement of the amount and nature of the correlative adjustment which is*

deemed to have been made. For purposes of this subparagraph, a primary adjustment shall not be considered to have been made (and therefore a correlative adjustment is not required to be made) until the first occurring of the following events with respect to the primary adjustment:

Supreme Court, U.S.
FILED
SEP 12 1980
MICHAEL RODAK, JR., CLERK

No. 80-178

In the Supreme Court of the United States

OCTOBER TERM, 1979

JOHN AND NORMA OGIONY, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

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v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole issue in this federal income tax case is whether the decision below correctly held that the net operating losses from the construction and operation of certain apartment complexes were those of its corporate owners.

The pertinent facts may be summarized as follows: Petitioners or their wholly-owned corporations formed two partnerships (Garden Partnership in 1966 and Losson Partnership in 1969) for the purpose of constructing rental apartments on certain undeveloped property in New York. They were unable to obtain loans for the apartment projects because the market interest rate for mortgage financing was in excess of the maximum rate chargeable to individuals under the usury law of New

York.[1] However, loans at a higher interest rate were available to corporations. Accordingly, petitioners decided to utilize two corporations, Garden Village Builders, Inc., and Losson Gardens, Inc., to borrow the necessary funds (Pet. App. 18-19, 31).

Garden Partnership and Losson Partnership then transferred title in the parcels of land they intended to develop to the corporations, so that the corporations became the mortgagors of record and retained title to those parcels during most of the period in question. In turn, the corporations transferred all funds obtained from the mortgage loans to the partnerships, which thereupon paid the expenses incurred in the construction and operation of the apartment projects (Pet. App. 19-20).

On their individual income tax returns, petitioners claimed distributive shares of the net operating losses reported by the partnerships. Thereafter, on audit, the Commissioner of Internal Revenue disallowed the claimed losses on the ground that they could only be claimed by the corporations and not the partnerships (Pet. App. 20). In this suit brought by petitioners for redetermination of the resulting deficiencies, the Tax Court ruled that the corporations were the proper entities to report the income and expenses generated from the construction and operation of the apartment complexes (Pet. App. 49-52). Moreover, the court rejected petitioners' contention that the deficiency determination was an arbitrary application of Section 482 of the Internal Revenue Code because the Commissioner's determinations were not based upon that provision (Pet. App. 51-52). The court of appeals

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[1]N.Y. Gen. Oblig. Law § 5-501 (McKinney 1967) limited the maximum rate chargeable to individual borrowers to 6%. In 1968, § 5-501 was amended to allow a maximum interest rate of 7 1/2%, and in 1973 a maximum rate of 8%.

affirmed. It held that " 'income from property must be taxed to the corporate owner * * * unless the corporation is a *purely passive dummy* * * *' " (emphasis in original) (Pet. App. 20). The court of appeals also rejected petitioners' Section 482 argument, agreeing with the Tax Court's disposition of that issue (Pet. App. 21-22).

1. The decision below correctly held that the losses in question were deductible only by the corporations and not the partnerships. It is well settled that if a corporation is organized for a business purpose, or if it engages in business activity, it must be recognized for tax purposes. *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943). The cases following *Moline Properties* have generally held that income or losses from property properly belong to the corporate owner unless the corporation is purely passive. *Strong* v. *Commissioner*, 66 T.C. 12, 22 (1976), aff'd without opinion, 553 F. 2d 94 (2d Cir. 1977); *Harrison Property Management Co.* v. *United States*, 475 F. 2d 623, 626 (Ct. Cl. 1973); *Collins* v. *United States*, 386 F. Supp. 17, 19-20 (S.D. Ga. 1974), aff'd per curiam, 514 F. 2d 1282 (5th Cir. 1975).

Here, the corporations were clearly not passive. The formation of Losson Corporation and Garden Corporation was undertaken to circumvent the New York usury law and to secure financing. The corporations therefore served a valid business purpose, if not business necessity. See *Strong* v. *Commissioner, supra*, 66 T.C. at 24; *Collins* v. *United States, supra*, 386 F. Supp. at 21; *Bolger* v. *Commissioner*, 59 T.C. 760, 766 (1973). Moreover, the actual borrowing of funds by the two corporations was undisputably a business activity, as were their ownership of the property during construction and the discharge of their legal obligation to make the debt service payments. See *Paymer* v. *Commissioner*, 150 F. 2d 334, 336-337 (2d Cir. 1945); *Strong* v. *Commissioner, supra*, 66 T.C. at 25;

Collins v. *United States, supra.* Accordingly, under *Moline Properties* and the authorities that have followed it, Losson Corporation and Garden Corporation are separate taxable entities which are required to recognize the income and losses derived from their properties. Petitioners may not claim the losses of those corporations as their own.[2]

2. Petitioners contend (Pet. 8-10) that the Commissioner improperly allocated their claimed deductions to Losson Corporation and Garden Corporation under Section 482 of the Internal Revenue Code of 1954 without giving them notice of such allocation. Section 482 provides, *inter alia*, that the Commissioner may allocate expenses between commonly controlled organizations if he determines that such allocation is necessary to clearly reflect the income of such organizations. But no such

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[2]*Helvering* v. *Lazarus & Co.*, 308 U.S. 252 (1939), and *United States* v. *Brager Building & Land Corp.*, 124 F. 2d 349 (4th Cir. 1941), upon which petitioners rely (Pet. 7-8), are not to the contrary. In *Lazarus & Co.*, this Court characterized a sale and leaseback of property for 99 years as a loan to Lazarus (the "seller") secured by the property and held that Lazarus was entitled to the depreciation deductions since it effectively bore the burden of the wasting of the business property. *Helvering* v. *Lazarus & Co., supra*, 308 U.S. at 254. Here, on the other hand, the construction loans were issued to Losson Corporation and Garden Corporation, not to the partnerships or petitioners. The corporations were obligated to repay the loans and they also bore the burden of the wear and exhaustion of the apartment complexes during the years in question. Hence, the corporations, in accordance with *Lazarus*, should be entitled to the depreciation deductions from the property.

Moreover, *Brager Building & Land Corp.* is distinguishable. There, the court ruled that the corporation involved could be disregarded for tax purposes because it, unlike Losson Corporation or Garden Corporation, had no business activities and served no business purpose. (The corporation merely held title to real estate as an agent for a partnership to avoid further complications upon the death of one of the partners.)

notice was forthcoming simply because the Commissioner did not act under Section 482 and the petitioners may not compel him to do so. See Treasury Regulations on Income Tax, Section 1.482-1(b)(3) (26 C.F.R.). As the court of appeals noted (Pet. App. 21-22):

> * * * the record is clear that the Commissioner did not invoke section 482 in denying appellants' deductions. The statutory notices do not mention the statute. Rather the Commissioner relied on the principle that the corporations, as owners of the property, were the proper parties to claim the deductions. We agree with the Tax Court that there is no reason in this case to depart from the general rule that courts will not look behind the statutory notice in order to ascertain which provisions the Commissioner relied upon in making his determination. *Branerton Corp.* v. *Comm'r*, 64 T.C. 191, 200 (1975); *Greenberg's Express, Inc.* v. *Comm'r*, 62 T.C. 324, 327 (1974). We are fortified in this conclusion by the responses of the Commissioner to interrogatories in which he repeatedly denied that his determination had been based on section 482.[3]

Moreover, even if Section 482 were invoked, the result would not be different. It would still be necessary to apply *Moline Properties* and its progeny to determine whether net operating losses should be allocated to the corporations.

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[3]Petitioners' reliance (Pet. 9-10) on *Commissioner* v. *Chelsea Products, Inc.*, 197 F. 2d 620, 624 (3d Cir. 1952), and *Grenada Industries, Inc.* v. *Commissioner*, 17 T.C. 231, 251 (1951), aff'd, 202 F. 2d 873 (5th Cir. 1953), is misplaced because in both cases the Commissioner proceeded under the statutory predecessor of Section 482.

3. Contrary to petitioners' final argument (Pet. 12), the Commissioner's position in the instant case is not inconsistent with Rev. Rul. 76-26, 1976-1 Cum. Bull. 10, and Rev. Rul. 75-31, 1975-1 Cum. Bull. 10. In those rulings, limited partnerships were considered the owners of certain housing projects for tax purposes although title was passively held by Limited Profit Housing Corporations. These special corporations were comprehensively regulated and controlled by the state and were characterized as "agents" of the limited partnerships. Here, on the other hand, the corporations were not mere agents or nominees of the partnerships, but themselves engaged in substantial business activities (Pet. App. 49-50). See *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 437 (1949) (a corporation is not an agent of its shareholders by virtue of their stock ownership in the corporation).[4]

It is therefore respectfully submitted that the petition for a writ of certiorari be denied.

WADE H. MCCREE, JR.
Solicitor General

SEPTEMBER 1980

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[4] *Beran* v. *Commissioner*, 40 T.C.M. (CCH) 163, 168-169 (1980) (Pet. 13), is likewise distinguishable. The Tax Court there held, in part, that the shareholder was entitled to an interest deduction for amounts he paid on a "reloan" from his controlled corporation which had originally borrowed the funds from a bank on his behalf to circumvent the state usury law. It was noted that the reloan to the shareholder at the same interest rate that had been charged the corporation should be treated as a loan for tax purposes. Here, however, the borrowed funds were merely transferred, not reloaned, to the partnerships. Accordingly, any mortgage interest payments were made only on the loans issued to the corporations.

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